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In the Supreme Court of the United States

OCTOBER TERM, 1996

UNITED STATES OF AMERICA, PETITIONER

v.

ESTATE OF FRANCIS J. ROMANI

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Since 1797, Congress has provided that any claim of the United States against an insolvent estate "shall be paid first" (31 U.S.C. 3713(a)). Since 1913, Congress has provided that a federal tax lien is not valid against a judgment lien creditor until notice of the tax lien has been filed (26 U.S.C. 6323(a)).

The question presented in this case is whether a federal tax claim against an insolvent estate is to "be paid first" when a judgment lien arose before the notice of tax lien was filed.

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OPINIONS BELOW

The opinion of the Supreme Court of Pennsylvania (Pet. App. 1a-13a) is reported at 688 A.2d 703. The opinions of the Superior Court (Pet. App. 15a-20a) and the Court of Common Pleas (Pet. App. 21a-25a) are not officially reported.

JURISDICTION

The judgment of the Supreme Court of Pennsylvania was entered on January 17, 1997. The petition for a writ of certiorari was filed on April 10, 1997, and was granted on June 27, 1997. The jurisdiction of this Court rests upon 28 U.S.C. 1257(a).

STATUTES INVOLVED

1. 26 U.S.C. 6321 provides:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

2. 26 U.S.C. 6323(a) provides, in relevant part:

> The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof * * * has been filed by the Secretary.

3. 31 U.S.C. 3713(a) provides, in relevant part:

(1) A claim of the United States Government shall be paid first when—

> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed; or

> (B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

STATEMENT

1. On January 25, 1985, a judgment for $400,000 was entered in favor of Romani Industries, Inc., against Francis J. Romani in the Court of Common Pleas of the Commonwealth of Pennsylvania. Romani Industries did not obtain a writ of execution, or otherwise seize any property of the debtor, in satisfaction of the judgment. The judgment remains unpaid (Pet. App. 22a).

After the date of that judgment, the Internal Revenue Service filed notices of federal tax liens on the property of Francis J. Romani. A federal tax lien arises by operation of law in the property of any taxpayer who "neglects or refuses to pay the [tax] after demand" (26 U.S.C. 6321). A notice of the federal tax lien is to be filed in the office "designated by the laws of [the] State, in which the property subject to the lien is situated" (26 U.S.C. 6323(f)). The liens for which notices were filed in this case were for unpaid taxes and penalties totalling approximately $400,000 for the years 1982, 1985, 1987, 1988 and 1989 (Pet. App. 2a).

Mr. Romani died on January 13, 1992. The administrator of his estate sought to transfer the only asset of the estate—real estate having a value of approximately $53,000—to Romani Industries in satisfaction of its outstanding judgment claim. The United States objected to that transfer and filed a proof of claim for federal taxes and interest totalling

approximately $489,000 (Pet. App. 2a). Because the debts of the estate greatly exceed its assets, and the estate is thus insolvent (*ibid.*), the United States claimed first priority for payment of its claim from the assets of the estate under what is known as the "absolute priority" statute. This statute, which was first enacted in 1797 (Act of March 3, 1797, ch. 20, § 5, 1 Stat. 515), was long designated as Section 3466 of the Revised Statutes and is now codified at 31 U.S.C. 3713(a). It provides, in relevant part, that "[a] claim of the United States Government shall be paid first when * * * the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor." 31 U.S.C. 3713(a)(1)(B).[1]

Romani Industries contended, however, that the "absolute priority" that Congress has long established for claims of the United States against insolvent estates was impliedly repealed in 1966, for tax claims, by 26 U.S.C. 6323(a). That provision, which was first enacted in 1913 (Act of March 4, 1913, ch. 166, 37 Stat. 1016), provides that the federal tax lien "shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof * * * has been filed by the Secretary." 26 U.S.C. 6323(a). Romani Industries claimed that, because it became a "judgment lien

[1] Under this "absolute priority" statute, the claims of the United States are also to be paid first when an insolvent debtor "makes a voluntary assignment of property," when property of an absent insolvent debtor is attached, or when "an act of bankruptcy is committed" (31 U.S.C. 3713(a)(1)). In 1978, however, Congress amended the statute to make it inapplicable to bankruptcy cases brought "under title 11" of the United States Code. 31 U.S.C. 3713(a)(2); see note 4, *infra*.

creditor" before notice of the federal tax lien was filed, it is entitled to priority under 26 U.S.C. 6323(a) and that the "absolute priority" rule of 31 U.S.C. 3713 is therefore inapplicable to this case.

2. a. The Court of Common Pleas agreed with Romani Industries that 26 U.S.C. 6323(a) impliedly repealed—for federal tax debts—the absolute priority rule of 31 U.S.C. 3713(a) (Pet. App. 21a-25a). The court did not discuss or cite the several federal decisions that had rejected this interpretation of these federal statutes. See, *e.g.*, *Nesbitt* v. *United States*, 622 F.2d 433 (9th Cir. 1980), aff'g 445 F. Supp. 824 (N.D. Cal 1978), cert. denied, 451 U.S. 984 (1981); *Kentucky* v. *United States*, 383 F.2d 13, 14 (6th Cir. 1967). Instead, the court adopted the reasoning of one of the conflicting opinions of the equally-divided court in *In re Estate of Berretta*, 426 A.2d 1098 (Pa. 1981), which concluded that the provisions of 26 U.S.C. 6323(a) evidence a congressional intent to limit the absolute priority otherwise established for the collection of federal claims (Pet. App. 24a).[2] The court stated that this conclusion was supported by the policy concern that application of the "absolute prior-

[2] The Pennsylvania courts have long taken a narrow view of the "absolute priority" statute, in a series of cases that are collected and criticized in Note, *Nesbitt v. United States: Denying an Implied Tax Lien Exception to the Federal Priority in Insolvency*, 33 Cath. U. L. Rev. 741, 753-759 (1984). The opinion from *Estate of Berretta* on which the court chose to rely in this case was criticized by the opposing opinion from the equally-divided court in *Estate of Berretta* because it "transformed its view of what Congress should do into the presumption that Congress has in fact impliedly repealed the Insolvency Statute as to tax liens." *In re Estate of Berretta*, 426 A.2d at 1108 (Roberts, J.).

ity" statute to federal tax claims could "frustrate legitimate commercial expectations" (*id.* at 23a).

b. The Superior Court affirmed (Pet. App. 15a-20a). The court concluded that the governing principle of statutory construction is that an inconsistency between conflicting provisions is to be resolved by allowing the more specific provision to prevail over the more general one (*id.* at 20a). The court stated that 26 U.S.C. 6323(a) is the more specific provision and should therefore prevail over "the general provisions of Section 3713" in any conflict between them (Pet. App. 20a).

The Superior Court acknowledged that this Court has held that "[o]nly the plainest inconsistency would warrant * * * finding an implied exception to the operation of so clear a command as that of" the absolute priority statute (Pet. App. 18a, quoting *United States* v. *Emory*, 314 U.S. 423, 433 (1941)). The Superior Court concluded, however, that this exacting standard is met—and that the two statutes are "most certainly, conflicting"—because "[i]n the present context * * * the government's relative priority as a creditor differs depending upon which section is applied" (Pet. App. 19a).

c. The Supreme Court of Pennsylvania affirmed (Pet. App. 1a-13a). The court acknowledged that the test applied by this Court in *United States* v. *Key*, 397 U.S. 322 (1970), governs in determining whether 26 U.S.C. 6323(a) impliedly repealed the absolute priority rule of 31 U.S.C. 3713(a) for the collection of tax debts (Pet. App. 5a-6a). In *Key*, the Court stated that an implied repeal of that statute cannot befound unless (i) there is a facial or "logical[] inconsisten[cy]" between the two statutes, (ii) the allegedly conflicting statute would "be rendered

redundant" if the "absolute priority" statute applied or (iii) the "language or legislative history" of the allegedly repealing provision reveals "a purpose incongruous with * * * application" of the absolute priority rule (397 U.S. at 326).

The Pennsylvania Supreme Court determined that the two statutes are facially inconsistent because, "with respect to tax liens, section 6323 provides for a 'first in time' priority while section 3713 gives absolute priority to the United States" (Pet. App. 6a-7a). The court concluded that the history and purpose of Section 6323(a) evidence "a congressional intent that federal priorities be limited in the tax area, regardless of whether the debtor is insolvent" (Pet. App. 13a).[3]

The Pennsylvania Supreme Court stated that its conclusions were reinforced by the rationale of this Court's decision in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979). In *Kimbell Foods*, this Court held that, in the absence of any federal statutory directive, the relative priority of private liens and consensual liens that arise from government lending programs is to be determined under

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[3] In reaching that conclusion, the Pennsylvania court did not address the fact that, in enacting the Federal Tax Lien Act (and on one later occasion as well), Congress declined to enact a companion bill that would have repealed application of the "absolute priority" statute to federal tax claims. By contrast, in *Nesbitt* v. *United States*, 445 F. Supp. at 829, the court stated:

> This Court cannot lightly disregard the fact that Congress has been requested on at least two occasions to amend [the absolute priority statute] in a manner which would achieve the result sought here by plaintiff, but it has not yet so amended that section.

nondiscriminatory state laws (440 U.S. at 740). This Court noted in *Kimbell Foods* that commercial transactions are ordinarily formed in reliance upon state commercial law and that a different rule for commercial transactions involving the federal government could upset ordinary business expectations (*id.* at 739). The Pennsylvania Supreme Court recognized that "*Kimbell Foods* involves the priority to be accorded a federal consensual loan where the debtor is solvent, and the case at bar involves the question of the priority to be accorded a federal tax lien where the debtor is insolvent" (Pet. App. 11a). The court nonetheless concluded that the same concerns apply to both cases, for "the grant of absolute federal priority in insolvency cases, as in solvency cases, would be destructive of commercial stability and would frustrate legitimate commercial expectations" (*id.* at 13a).

The Pennsylvania Supreme Court acknowleged that its holding conflicts with the decisions of the "federal courts that have held that section 3713 provides for absolute priority in tax lien cases" (Pet. App. 12a n.17, citing, *e.g.*, *Nesbitt* v. *United States*, *supra*). The court stated, however, that it was "not persuaded by the reasoning of" those decisions (*ibid.*).

SUMMARY OF ARGUMENT

The absolute priority statute has been in force since "the earliest days of the Republic" and gives the United States "priority over all other claimants in collecting debts due it from insolvent debtors" (*United States* v. *Key*, 397 U.S. 322, 324 (1970)). Under this venerable statute, debts owed to the United States by an insolvent estate are to "be paid first" (31 U.S.C. 3713(a)(1)), even when, as in the present case, a competing creditor has a valid and enforceable judgment lien against the property of the estate (*Thelusson* v. *Smith*, 15 U.S. (2 Wheat.) 396, 425 (1817)).

The Federal Tax Lien Act (26 U.S.C. 6323(a)) did not impliedly repeal application of the absolute priority statute to tax claims of the United States. From its first enactment, the central purpose of the absolute priority statute has been to ensure the collection of taxes from insolvent debtors. The statute contains a "clear * * * command" and "[o]nly the plainest inconsistency would warrant * * * finding an implied exception to [its] operation" (*United States* v. *Key*, 397 U.S. at 324-325).

No such "plain[] inconsistency" exists between the absolute priority statute and 26 U.S.C. 6323(a). The two statutes are logically consistent and address separate concerns. 26 U.S.C. 6323(a) addresses the rights of conflicting lienholders in competition with the federal tax lien. The absolute priority statute, by contrast, applies only to the debts owed by an insolvent to the government, applies "whether or not [those debts are] secured by a lien" and specifies that all such debts must be paid in preference to the claims of others (*United States* v. *Vermont*, 377 U.S. 351, 357 (1964)). An unconditional application of the absolute priority statute would not deprive Section 6323(a) of meaning, for the two statutes operate in different contexts and to different subjects.

The history of Section 6323(a) shows that, in enacting the tax lien provisions, Congress did not intend impliedly to repeal the absolute priority statute. Congress enacted Section 6323(a) in 1966 to expand the classes of private liens that, since 1913, had been protected against unfiled federal tax liens. In doing

so, Congress declined to enact a related proposal that would have repealed application of the absolute priority statute to federal tax claims. Four years later, Congress again declined to enact the same legislative proposal. And, in 1978, when Congress *did* amend the absolute priority statute to make it inapplicable to bankruptcy cases (31 U.S.C. 3713(a)(2)), Congress did not further revise it to make it inapplicable to tax claims. The provisions of the statute thus still contain as "clear a command" as ever (*United States* v. *Key*, 397 U.S. at 325). The statute provides an absolute priority to the United States for tax claims against insolvent estates and "makes no exception in favour of prior judgment-creditors" (*Thelusson* v. *Smith*, 15 U.S. (2 Wheat.) at 425).

The Pennsylvania Supreme Court erred in reasoning that *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), supports a contrary conclusion. *Kimbell Foods* involved "the priority to be accorded a federal consensual loan where the debtor is solvent" and where no federal statutory priority scheme existed (Pet. App. 11a). In that context, this Court adopted state law priority rules to avoid undue disruption of private credit markets (440 U.S. at 734). The Court emphasized in *Kimbell Foods*, however, that federal tax claims implicate a different and specific set of statutory rules and policy concerns and that "the importance of securing adequate revenues * * * justifies the extraordinary priority accorded federal tax liens" (*ibid.*).

The Court has long held, in rejecting similar challenges to application of the absolute priority statute, that any assertion that the statute is "inconvenient" to commercial creditors must be addressed to Con-

gress, not to this Court. *United States* v. *Fisher*, 6 U.S. (2 Cranch) 358, 390 (1805). Any objection to the application of the statute based upon its "inconvenience" to other creditors "proves too much" for, "[i]f [that objection] is sound as applied to this kind of a claim of the United States, it is equally sound as applied to all claims as to which the United States" has an absolute priority under 31 U.S.C. 3713(a). *United States* v. *Emory*, 314 U.S. 423, 431 (1941).

ARGUMENT

THE ABSOLUTE PRIORITY THAT CONGRESS ESTABLISHED FOR CLAIMS OF THE UNITED STATES AGAINST INSOLVENT ESTATES WAS NOT IMPLIEDLY REPEALED FOR TAX CLAIMS BY 26 U.S.C. 6323(A)

A. Under The Absolute Priority Statute, All Claims Of The United States Against An Insolvent Estate Are To Be Paid Before Claims Of Other Creditors Are Paid

1. For two hundred years, Congress has provided "an absolute priority for payment of debts due [the United States] from insolvent" debtors (*United States* v. *Key*, 397 U.S. 322, 329 (1970)). "Since the earliest days of the Republic, [31 U.S.C. 3713(a)] and its predecessors have given the Government priority over all other claimants in collecting debts due it from insolvent debtors. The present statute has existed almost unchanged since 1797, and its historical roots reach back to the similar priority of the Crown in England, an aspect of the royal prerogative, founded upon a policy of protecting the public revenues. The same policy underlies the federal statute, *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35 (1832), and it is established

that the terms of [the statute] are to be liberally construed to achieve this broad purpose." *United States* v. *Key*, 397 U.S. at 324 (footnotes omitted). See also *Beaston* v. *Farmers' Bank of Delaware*, 37 U.S. (12 Pet.) 102, 134 (1838).

When first enacted in 1789, the absolute priority statute applied only to customs duties and debts due to the United States on bonds. See Act of July 31, 1789, ch. 5, § 21, 1 Stat. 42. By 1797, however, the absolute priority of the United States was extended to encompass all debts due the government from the estate of an insolvent debtor. See Act of March 3, 1797, ch. 20, § 5, 1 Stat. 515; *United States* v. *Fisher*, 6 U.S. (2 Cranch) at 385. The language of the statute has remained substantially unchanged since that time. See, *e.g.*, Act of March 2, 1799, ch. 22, § 65, 1 Stat. 676; Act of September 13, 1982, Pub. L. No. 97-258, Subtit. III, §1, 96 Stat. 972. In its current formulation, the statute provides that "[a] claim of the United States Government shall be paid first" when "a person indebted to the Government is insolvent" or when "the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor." 31 U.S.C. 3713(a)(1).[4]

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[4] Since 1978, the absolute priority statute has expressly been made inapplicable to cases brought under the Bankruptcy Code (31 U.S.C. 3713(a)(2)), which contains a detailed and comprehensive set of priorities applicable to claims of the United States and other parties (11 U.S.C. 507). Prior to enactment of the Bankruptcy Code, the absolute priority statute had been treated separately within the priority provisions applicable to bankruptcy cases under Section 64 of the Bankruptcy Act, 11 U.S.C. 104 (1976). See *United States* v. *Marxen*, 307 U.S. 200, 202-203 (1939).

2. The claim of the United States in the present case for taxes owed by the insolvent estate is entitled to "be paid first" under the plain language of the absolute priority statute.

a. A tax debt owed to the United States is unquestionably a "claim of the United States Government" (31 U.S.C. 3713(a)(1)) within the scope of the broad language of the absolute priority statute. See *Massachusetts* v. *United States*, 333 U.S. 611, 625-626 (1948); *Illinois* v. *United States*, 328 U.S. 8, 9 (1946); *Price* v. *United States*, 269 U.S. 492, 499 (1926). Indeed, from the date of its first enactment to its present form, the most basic function of the statute has been to aid the government in the collection of public revenues. See, *e.g.*, *United States* v. *Key*, 397 U.S. at 324; *United States* v. *Fisher*, 6 U.S. (2 Cranch) at 388. As the Court stated in *United States* v. *Emory*, 314 U.S. 423, 426 (1941):

> The purpose of [the absolute priority statute] is "to secure adequate public revenues to sustain the public burden" (*United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35), and it is to be construed liberally in order to effectuate that purpose (*Bramwell* v. *U.S. Fidelity & Guaranty Co.*, 269 U.S. 483, 487).

b. It is undisputed that the estate involved in this case is insolvent within the meaning of the statute. The estate's debts exceed $489,000, and its sole asset is real estate worth approximately $53,000 (Pet. App. 2a, 22a). Since the estate "in the custody of the executor or administrator, is not enough to pay all debts of the debtor" (31 U.S.C. 3713(a)(1)(B)), the absolute priority statute applies to this case by its plain terms. Under the plain command of the statute, the federal

tax claim is therefore entitled to "be paid first" (31 U.S.C. 3713(a)(1)).

c. It is also well established that the claim of the United States against the insolvent estate is to be paid ahead of the claim of any judgment lienor—such as the private creditor in this case—who has not obtained possession of the disputed property by execution upon its lien. One hundred and eighty years ago, this Court held that the absolute priority statute requires debts owed to the United States to be paid first even when a competing creditor possesses a valid and enforceable judgment lien. In *Thelusson* v. *Smith*, 15 U.S. (2 Wheat.) 396, 425 (1817), as in the present case, the facts fell "precisely within" the scope of the absolute priority statute. The Court stated that (*ibid.*) (emphasis supplied):

> the question still remains * * * whether this right of preference [under the absolute priority statute] can cut out a prior judgment creditor? The law declares, "that in all cases of insolvency, &c., the debts due to the United States shall be first satisfied * * *." *These expressions are as general as any which could have been used, and exclude all debts due to individuals, whatever may be their dignity.* * * * *The law makes no exception in favour of prior judgment-creditors; and no reason has been, or, we think, can be, shown to warrant this court in making one.*

The Court concluded in *Thelusson* that, whenever title and possession remain in "the debtor's estate," the claim of the United States is to "be first satisfied" under the statute. *Id.* at 426. As Justice Cardozo explained for the Court more than a century later, "[t]he ruling [in *Thelusson*] was that the

general lien of a judgment upon the lands of an insolvent debtor is subordinate to the preference established by the [absolute priority] statute unless seizure by a marshal or some other equivalent act has made the lien specific and brought about a change of title or possession." *New York* v. *Maclay*, 288 U.S. 290, 293-294 (1933). Accord, *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 366 (1953); *United States* v. *Texas*, 314 U.S. 480, 485-486 (1941); *Conard* v. *Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 386, 441-443 (1828).[5]

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[5] This Court has "repeatedly reserved the question whether the priority given the United States by [Revised Statutes] § 3466 can be overcome even by a prior specific and perfected lien." *United States* v. *Vermont*, 377 U.S. 351, 358 n.8 (1964). The Court has never decided the issue because it has found, in each case, that the competing lien had not divested the debtor of title or possession and that the lien was therefore not sufficiently specific to raise the issue squarely. See, *e.g.*, *ibid.*; *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 365-366 (1953); *Illinois ex rel. Gordon* v. *Campbell*, 329 U.S. 362, 370 (1946); *United States* v. *Waddill, Holland & Flinn, Inc.*, 323 U.S. 353, 355-356 (1945); *United States* v. *Texas*, 314 U.S. 480, 484-486 (1941); *New York* v. *Maclay*, 288 U.S. 290, 294 (1933); *Spokane County* v. *United States*, 279 U.S. 80, 95 (1929).

The Court has concluded that a mortgage may effect a transfer of title, taking the property outside the estate of the debtor and therefore beyond the reach of the absolute priority statute. See *Conard* v. *Atlantic Insurance Co.*, 26 U.S. at 445-446. In so ruling, the Court did "not contemplate that exceptions were being made" from the absolute priority statute; instead, it "conceived that the funds or property affected, being covered by mortgage, belonged in fact to third persons, not to the insolvent debtor" (*Massachusetts* v. *United States*, 333 U.S. at 634 n.38). The Court "has been loath to expand" such an exception "to include other types of lien" (*ibid.*). The

The judgment creditor took no such action to obtain possession of the disputed property before the government's claim arose in this case (Pet. App. 2a). The "words [of the absolute priority statute], taken in their natural and usual sense, * * * embrace the case before the court" and thus "plainly give the United States the preference they claim" (*United States* v. *Fisher*, 6 U.S. (2 Cranch) at 385-386).

B. The Federal Tax Lien Act Does Not Repeal The Absolute Priority Of Tax Claims Of The United States Against Insolvent Estates

The Supreme Court of Pennsylvania acknowledged that the plain language of the absolute priority statute applies directly to this case (Pet. App. 6a). The court concluded, however, that the absolute priority created for claims of the United States by that statute had been impliedly repealed—for tax claims—by the enactment of the Federal Tax Lien Act of 1966, 26 U.S.C. 6323(a). The latter statute provides that the federal tax lien that arises by operation of law when a taxpayer neglects to pay an assessment (26 U.S.C. 6321) is not valid against private lien holders (including judgment lien creditors) until notice of the tax lien has been filed.

In concluding that Congress impliedly repealed application of the absolute priority statute to federal tax claims, the Pennsylvania Supreme Court failed to follow this Court's admonition that "[o]nly the plainest inconsistency would warrant * * * finding

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Court has emphasized that none of its decisions lends "support to the assumption that the doctrine of the mortgage cases, whatever its current vitality, would require the subordination of unsecured claims of the United States to a specific and perfected lien" (*United States* v. *Texas*, 314 U.S. at 486).

an implied exception to the operation" of the absolute priority statute (*United States* v. *Key*, 397 U.S. at 324-325).

1. During the long history of the absolute priority statute, this Court has frequently addressed claims of the type presented by respondent in this case. As long ago as 1805, in the earliest of these cases, the Court rejected the claim of a creditor who, while acknowledging (as respondent does in this case) that the absolute priority statute, by its terms, confers priority on the United States, nonetheless argued that Congress had, in some manner apart from the text of the statute, evidenced "an intent varying from that which the words import." *United States* v. *Fisher*, 6 U.S. (2 Cranch) at 386. Chief Justice Marshall made clear in his opinion for the Court in that case that, because the statute is "explicit" in providing priority to the United States (*id.* at 389), any creditor who seeks to establish an implied exception from the absolute priority statute bears a heavy burden. *Id.* at 386. See also *Beaston* v. *The Farmers' Bank of Delaware*, 37 U.S. (12 Pet.) at 134.

Applying that same reasoning, the Court has consistently emphasized in numerous subsequent cases that the absolute priority statute "on its face permits no exception whatsoever" (*United States* v. *Vermont*, 377 U.S. 351, 357 (1964); see also, *e.g.*, *United States* v. *Waddill, Holland & Flinn, Inc.*, 323 U.S. 353, 355 (1945)) and that "[o]nly the plainest inconsistency would warrant * * * finding an implied exception to the operation of so clear a command as that of [the absolute priority statute.]" *United States* v. *Emory*,

314 U.S. at 433.[6] See also *United States* v. *Moore*, 423 U.S. 77, 82-83 (1975).

Most recently, the Court held in *United States* v. *Key*, 397 U.S. at 332, that the absolute priority statute "must apply according to its terms except where expressly superseded, or where excluded by a later enactment 'plainly inconsistent' with it." The Court concluded in *Key* that such a "plain[] inconsistency" could be said to exist only if (i) the competing statute is logically inconsistent with the absolute priority statute; (ii) an unconditional application of the absolute priority statute would deprive the competing statute of any meaning; or (iii) the history and text of the competing statute reflect an actual intent by Congress to modify the absolute priority statute (397 U.S. at 324-326; see also *id.* at 321-332).[7]

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[6] In *United States* v. *Emory*, 314 U.S. at 433, the Court rejected the contention that Section 64 of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, which gave certain wage claimants priority over claims of the United States in bankruptcy cases, impliedly repealed application of the absolute priority statute to *non*bankruptcy cases. The Court held that the express alteration of the priority applicable in bankruptcy cases did not implicitly repeal application of the absolute priority statute to insolvencies outside of bankruptcy court (314 U.S. at 427):

> Neither the language of § 64(a) nor the Congressional history of the legislation here involved supports the proposition that § 64(a) was intended to eliminate, either partially or wholly, the priority of claims of the United States in non-bankruptcy proceedings.

See also *Massachusetts* v. *United States*, 333 U.S. 611 (1948).

[7] In *United States* v. *Key*, 397 U.S. at 332, the Court concluded that the provisions of what was then Chapter X of the Bankruptcy Act—which required "fair and equitable" treatment of creditors in a reorganization—were not "plainly inconsistent" with the absolute priority statute and did not impliedly repeal its application in such proceedings. The Court stated that "the statute literally applies, and no plain inconsistency with the scheme of Chapter X appears." *Ibid.*

2. The standard adopted by the Court in *Key* to evaluate claims of an implied repeal of the absolute priority statute is not satisfied in this case.

a. There is no logical inconsistency between the Federal Tax Lien Act and the absolute priority statute. The two statutes differ in their scope and address different concerns. The absolute priority statute governs the priority of claims of the United States only in insolvencies outside of bankruptcy court (see 31 U.S.C. 3713(a)(2)). By contrast, 26 U.S.C. 6323(a) governs the validity of the federal tax lien against specific types of security interests in cases involving solvent debtors and also in the many insolvency situations to which the absolute priority statute is inapplicable. This Court has long noted that Congress has intentionally chosen to establish greater protection for the United States in cases involving insolvent debtors than in cases "[w]here the debtor is not insolvent." *United States* v. *Vermont*, 377 U.S. at 358. See also *United States* v. *Key*, 397 U.S. at 329; *United States* v. *City of New Britain*, 347 U.S. 81, 85 (1954).

26 U.S.C. 6323(a) is concerned with the rights of conflicting lienholders in competition with the federal tax lien. The absolute priority statute, by contrast, applies only to the debts owed by an insolvent and applies "whether or not [those debts are] secured by a lien" (*United States* v. *Vermont*, 377 U.S. at 357). In the first case arising in this Court under the absolute priority statute, the Court explained that "no *lien* is

created by this law. * * * It is only a priority in payment * * * and this priority is limited to a particular state of things" (*United States* v. *Fisher*, 6 U.S. (2 Cranch) at 390).

As the Sixth Circuit has explained, the two statutes focus on different concerns, operate in different contexts, and are not logically inconsistent (*Kentucky* v. *United States*, 383 F.2d 13, 14-15 (1967)):

> We at once emphasize that of the statutes involved, one * * * is a priority statute, and the other—26 U.S.C. § 6323—is a lien statute. If we employ a literal reading of [the absolute priority statute], its language provides the answer to the question before us. We requote it for emphasis:
>
> > "*Whenever* * * * the estate of any deceased debtor, in the hands of the executors or administrators, *is insufficient to pay all the debts due from the deceased*, the debts due to the United States *shall be first satisfied.*
>
> The essentials for application of the statute are here present—the taxpayer is deceased; he was a debtor of the United States; his estate is insufficient to pay all his debts. Present these essentials, the debts owing the United States "shall be first satisfied."

The Ninth Circuit reached the same conclusion in *Nesbitt* v. *United States*, 622 F.2d 433 (1980), aff'g 445 F. Supp. 824 (N.D. Cal. 1978), cert. denied, 451 U.S. 984 (1981). The court noted that the absolute priority statute (445 F.Supp. at 829-830, adopted by reference, 622 F.2d at 433):

> grants a first priority to the Government as a creditor; [Section 6321] creates a lien on 'all the property' of a delinquent taxpayer. The [absolute] priority is not a lien; it covers all debts to the Government; it is available only in the case of an insolvent debtor whose property has passed to a third person—other than a trustee in bankruptcy —for the benefit of creditors; and it arises at the time of this transfer. The [Section 6321] tax lien covers only tax debts; it arises regardless of the solvency of the taxpayer; and it attaches at the time the assessment list is received by the collector.

Justice Whittaker expressed the same views in his concurring opinion in *James* v. *United States*, 366 U.S. 213 (1961), in which he concluded that the absolute priority statute remains applicable to tax claims notwithstanding the restrictions imposed on enforcement of the federal tax lien. He stated that, "even though the tax claim of the Government may be only a general lien, with notice thereof not yet filed in the proper local office pursuant to 26 U.S.C. § 6323, we have held that it must be accorded priority over the claims of all prior general lienholders" and it therefore has priority in insolvency cases "over the claims of others, including 'judgment creditors.'" 366 U.S. at 252 & n.4.

b. An unconditional application of the absolute priority statute would not deprive 26 U.S.C. 6323 of meaning. Section 6323 determines the effectivenesss of federal tax liens against other types of liens and, as this Court has noted, does "not attempt to give priority in all cases" to the federal lien. *United States* v. *City of New Britain*, 347 U.S. at 84. As this Court explained in *City of New Britain*, however, Congress *has* determined to give first priority to the

tax claims of the United States against insolvent estates in the absolute priority statute (*id.* at 85):

> When the debtor is insolvent, Congress has expressly given priority to the payment of indebtedness owing the United States, whether secured by liens or otherwise, by [what is now 31 U.S.C. 3713(a)]. In that circumstance, where all the property of the debtor is involved, Congress has protected the federal revenues by imposing an absolute priority.

As this Court noted in *City of New Britain*, the provisions of Section 6323 do not govern the relative rights of lien creditors in cases involving insolvents. The rights of creditors in cases involving insolvents are governed instead by the absolute priority statute. 347 U.S. at 85. The Court expressed the same conclusion in *United States* v. *Vermont*, 377 U.S. at 358, in which it explained that whether the government has a tax lien, and whether that lien would have priority under Section 6323, is irrelevant in cases to which the absolute priority statute applies: the government's priority in insolvencies is based merely on whether the government has a "claim" (37 U.S.C. 3713(a)) and applies "whether or not [that claim is] secured by a lien" (*United States* v. *Vermont*, 377 U.S. at 357).

The two statutes thus have different areas of concern and different objectives. Section 6323 applies to situations involving solvent debtors and also to the insolvency situations to which the absolute priority statute is inapplicable. The absolute priority statute applies only to insolvencies manifested in one of the modes specified in 31 U.S.C. 3713(a)—to cases in which the estate of a debtor is insolvent, cases in

which the debtor makes a voluntary assignment of his property or commits an act of bankruptcy and cases in which the property of an absent debtor is attached.[8] 31 U.S.C. 3713(a)(1). See *United States* v. *Fisher*, 6 U.S. (2 Cranch) at 390; note 1, *supra*. As this Court stated in *United States* v. *Oklahoma*, 261 U.S. 253, 260 (1923):

> Mere inability of the debtor to pay all his debts in ordinary course of business is not insolvency within the meaning of the act, but it must be manifested in one of the modes pointed out in the latter part of the statute which defines or explains the meaning of insolvency referred to in the earlier part. *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35; *United States* v. *Fisher*, 2 Cranch, 358, 390; *United States* v. *Hooe*, 3 Cranch, 73, 90; *Prince* v. *Bartlett*, 8 Cranch, 431, 433; *Conard* v. *Atlantic Insurance Co.*, 1 Pet. 386, 439;

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[8] The term "act of bankruptcy" is not defined in the absolute priority statute but has been held to incorporate the definition of that term contained in the Bankruptcy Act of 1898, ch. 541, § 3(a)(5), 30 Stat. 546 (11 U.S.C. 21(a)(5) (1976)). See *Jonathan's Landing, Inc.* v. *Townsend*, 960 F.2d 1538, 1540 (11th Cir. 1992); *Carter* v. *Carter*, 681 F. Supp. 323, 326 n.13 (E.D. Va. 1988). Under the Bankruptcy Act of 1898, the term "act of bankruptcy" includes such actions by a debtor as fraudulent conveyances and preferential transfers. 11 U.S.C. 21 (a)(1) and (2) (1976).

The current Bankruptcy Code abolished the concept of "acts of bankruptcy" and does not contain a definition of that term. *Jonathan's Landing, Inc.* v. *Townsend*, 960 F.2d at 1543 n.20; S. Rep. No. 989, 95th Cong., 2d Sess. 34 (1978). Although the concept of an act of bankruptcy is no longer applied in bankruptcy law, it remains a part of the absolute priority statute. 31 U.S.C. 3713(a)(1)(a)(iii); see *Carter* v. *Carter*, 681 F. Supp. at 326 n.13.

Brent v. *Bank of Washington*, 10 Pet. 596, 611; *Field* v. *United States*, 9 Pet. 182, 201.

The two statutes also operate with different force in the contexts to which they apply. In order to defeat an unfiled federal tax lien under Section 6323, the competing lien must be "choate"—the identity of the lienor, the property subject to the lien, and the amount of the lien must be established. *United States* v. *Pioneer American Insurance Co.*, 374 U.S. 84, 89 (1963); *United States* v. *City of New Britain*, 347 U.S. at 84. Different standards apply under the absolute priority statute. Under the latter statute, a competing claimant can defeat the federal claim, if at all, only by obtaining title to or possession of the debtor's property before the right of preference accrued to the United States. *United States* v. *Vermont*, 377 U.S. at 357-358; *Thelusson* v. *Smith*, 15 U.S. (2 Wheat.) at 425. See note 5, *supra*. An unconditional application of the absolute priority statute does not disturb application of Section 6323 in the contexts to which the latter applies and thus does not render that statute meaningless.

c. The history of 26 U.S.C. 6323 shows that, in enacting the tax lien provisions, Congress did not intend impliedly to repeal the absolute priority statute. Beginning in 1866, Congress established a federal tax lien upon all property owned by a delinquent taxpayer. See 26 U.S.C. 6321; Act of July 13, 1866, ch. 184 § 9, 14 Stat. 98. In response to a decision of this Court holding that an unrecorded tax lien had priority in a delinquent taxpayer's property even over a purchaser for value without notice (*United States* v. *Snyder*, 149 U.S. 210 (1893)), the statute was amended in 1913 to make the tax lien ineffective against a

mortgagee, purchaser or judgment creditor whose interests arose before notice of the tax lien was filed. Act of March 4, 1913, ch. 166, 37 Stat. 1016. The language of the 1913 statute has been carried forward in numerous revenue acts and now appears as Section 6323(a) of the Internal Revenue Code, 26 U.S.C. 6323(a). The protection established for a judgment lien creditor (such as the private creditor in this case) from an unfiled federal tax lien has thus existed since 1913.

In 1966, Congress determined to give similar protection to additional types of secured transactions. The Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125, amended the statute to protect holders of various commercial security interests from an unfiled tax lien. See H.R. Rep. No. 1884, 89th Cong., 2d Sess. 1-2 (1966) (1966-2 C.B. 815, 815-816); S. Rep. No. 1708, 89th Cong., 2d Sess. 1-2 (1966) (1966-2 C.B. 876, 876-877).[9] The legislative history of that Act reflects that these amendments to the tax lien statute were *not* intended to repeal or modify the absolute priority statute. Indeed, Congress declined to enact proposals that were made at that very time for that very purpose.

In proposing the legislation that resulted in the Federal Tax Lien Act, the American Bar Association also proposed that the absolute priority statute be amended to subject that statute to the priorities established under the Bankruptcy Act and the Internal Revenue Code. See American Bar Associa-

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[9] In 1939, the successor of the 1913 statute had been amended similarly to include protection from the unfiled federal tax lien for the holders of a pledge. Revenue Act of 1939, ch. 247, § 401, 53 Stat. 882.

tion, *Final Report of the Committee on Federal Liens* 7, 124 (1959) (*Final Report*), contained in *Hearings on the Priority of Federal Tax Liens and Levies Before the House Comm. on Ways and Means*, 89th Cong., 2d Sess. at 85, 199 (1966) (House Hearings).[10] The ABA proposal and report were submitted to Congress, and three bills were introduced containing this proposed revision of the absolute priority statute. *House Hearings*, *supra*, at 75-88, 196-201. When the Federal Tax Lien Act was enacted, however, the bills proposing amendments to the absolute priority statute died in committee. See 105 Cong. Rec. 1030, 1258 (1959) (Index). This history is plainly inconsistent with the conclusion of the Pennsylvania Supreme Court in this case that "the Tax Lien Act of 1966 evidences a congressional intent that federal priorities be limited in the tax area, regardless of whether the debtor is insolvent" (Pet. App. 13a).

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[10] The ABA's proposed amendment would have specified that nothing in the absolute priority statute "shall impair * * * any other valid lien or security interest which would have been entitled to priority over the claim of the United States immediately preceding such divestment." *Final Report*, *supra*, at 122. The purpose of the proposed amendment, which Congress declined to enact, was to "preserve, ahead of the priority of non-lien federal claims, any non-federal lien or security that would have been entitled to priority over the claim of the United States immediately prior to the divestment of the debtor's property" and to "assure, contrary to the suggestions made in some decisions, that any lien which would qualify for priority in the absence of insolvency would continue to enjoy such priority." *Final Report*, *supra*, at 124. Under the ABA's proposal, the order of priorities specified in 26 U.S.C. 6323(a) would have been applicable in all insolvency situations.

The subsequent history of related legislation confirms that Congress did not intend impliedly to repeal the absolute priority statute. In 1970, the ABA again submitted to the Senate Judiciary Committee a proposed amendment to the absolute priority statute that would have repealed its application to tax claims. S. 2197, 92d Cong., lst Sess. (1971); see William T. Plumb, *The Federal Priority in Insolvency: Proposals for Reform*, 70 Mich. L. Rev. 1, 9-10 (1971). This bill also died in committee.

In enacting the Federal Tax Lien Act and again four years later, Congress thus declined to adopt proposed legislation that would have made the absolute priority statute inapplicable to tax claims. In view of this history of congressional rejection of such proposals, respondent cannot satisfy its burden of demonstrating a "manifestation of congressional intent" that "implies such an exception" was intended (*United States* v. *Key*, 397 U.S. at 324). As the Ninth Circuit correctly concluded in *Nesbitt* v. *United States*, 445 F. Supp. at 828, adopted by reference 622 F.2d at 433:

> There is nothing in either the language or the legislative history of [26 U.S.C. 6323] to indicate that Congress intended to make tax liens the federal government's sole remedy for the collection of unpaid taxes. To the contrary, Congress intended tax liens to supplement existing means for the collection of taxes, including [the absolute priority statute]. There is, therefore, no basis for saying that Congress, by creating federal tax liens, intended to modify [the absolute priority statute] in any way.

The fact that Congress twice declined proposals to remove tax claims from the absolute priority statute, while enacting related legislation, demonstrates that Congress did *not* intend to modify that statute. *Nesbitt* v. *United States*, 622 F.2d at 433, aff'g 445 F. Supp. at 829:

> This Court cannot lightly disregard the fact that Congress has been requested on at least two occasions to amend [the absolute priority statute] in a manner which would achieve the result sought here by plaintiff, but it has not yet so amended that section.

Accord, *Estate of Silberman*, 46 Cal. Rptr. 610, 615 (Ct. App. 1995) ("The fact that [C]ongress was twice presented with proposals to accomplish this end, and did not adopt them strongly supports the inference that it was informed of the policy considerations in favor of such legislation and nevertheless declined to amend the [absolute priority statute]."). Cf. *Miner* v. *Atlass*, 363 U.S. 641, 651 (1960) ("We do not think this failure to enact the proposed amendments can be explained away by suggesting that * * * amendment of the General Rules [was thought] unnecessary.").

Over the last two hundred years, Congress has frequently amended, codified and recodified the absolute priority statute. Indeed, it has done so twice since the Federal Tax Lien Act of 1966 was enacted. In 1978, Congress amended the absolute priority statute to make it inapplicable to bankruptcy cases. 31 U.S.C. 3713(a)(2); note 4, *supra*. And, in 1982, Congress recodified the absolute priority statute to make minor revisions in its terminology. See Act of September 13, 1982, Pub. L. No. 97-258, Subtit. III, § 1, 96 Stat. 972. In doing so, however, Congress emphasized that

no substantive change in the law was intended. H.R. Rep. No. 651, 97th Cong., 2d Sess. 2-3 (1982).

Congress has never modified the absolute priority statute to eliminate its application to federal tax claims. By recodifying the absolute priority statute in 1978 and 1982 without making the twice-proposed change in its application to tax claims, Congress reaffirmed the broad and "clear * * * command" of the statute (*United States* v. *Key*, 397 U.S. at 325). The words that Congress has employed in the absolute priority statute remain "broad and sweeping and, on their face, admit of no exception to the priority of claims of the United States" (*United States* v. *Waddill, Holland & Flinn, Inc.*, 323 U.S. at 355).

d. Under the standards applied by this Court in *United States* v. *Key*, 397 U.S. at 324-326, (i) Section 6323 of the Internal Revenue Code is not inconsistent with the absolute priority statute; (ii) an unconditional application of the absolute priority statute would not make Section 6323 meaningless; and, (iii) the history and text of Section 6323 and the absolute priority statute do not reflect an intent by Congress to modify the latter statute. The "plainest inconsistency" that would be required for this Court to find an implied exception to the operation of the absolute priority statute thus does not exist (*United States* v. *Key*, 397 U.S. at 325). Instead, as this Court has observed on several occasions, the statute contains as "clear a command" now as ever (*ibid.*) and the asserted "inconsistency is wholly wanting here" (*United States* v. *Emory*, 314 U.S. at 433).

3. a. The Pennsylvania Supreme Court erred in relying on *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), as guidance "on the policy considerations that underlie the question of whether the

government in the tax arena is to be treated as an ordinary creditor or as a creditor with super-priority" (Pet. App. 7a). The *Kimbell Foods* case did not involve federal tax claims; nor did it involve insolvent debtors. Instead, it involved "the priority to be accorded a federal consensual loan where the debtor is solvent" and where no federal statutory priority scheme existed (*Id.* at 11a). In *Kimbell Foods*, in the absence of any applicable federal statutory scheme, the Court adopted the state law priority rules "on which private creditors base their daily commercial transactions" in order to avoid undue disruption of private credit markets. 440 U.S. at 729. The Court concluded, in the absence of any "congressional directive," that the relative priority of private liens and consensual liens arising from government lending programs should be determined under non-discriminatory state laws. *Id.* at 740.

In *Kimbell Foods*, however, the Court expressly noted that an entirely different set of statutory rules and policy concerns becomes applicable when the government is collecting taxes as an involuntary creditor of a taxpayer (440 U.S. at 734):

> That collection of taxes is vital to the functioning, indeed existence, of government cannot be denied. * * * The importance of securing adequate revenues to discharge national obligations justifies the extraordinary priority accorded federal tax liens through the choateness and first-in-time doctrines. By contrast, when the United States operates as a moneylending institution under carefully circumscribed programs, its interest in recouping the limited sums advanced is of a different order. Thus, there is less need here than in the tax lien area to invoke protective measures against defaulting debtors in a manner disruptive of existing credit markets.

As an involuntary creditor of delinquent taxpayers, the government cannot "control the factors that make tax collection likely." *Id.* at 736. As a consensual lender, however, the government acts "voluntarily, with detailed knowledge of the borrower's financial status" and "[b]y carefully selecting loan recipients and tailoring each transaction with state law in mind," it can "establish[] terms that will secure repayment" (*ibid.*).

Recognizing the significant difference between federal tax liens and the consensual liens created by government loan programs, the Court stated that "'[a]s a quasi-commercial lender, [the government] does not require * * * the special priority which it compels as sovereign' in its tax-collecting capacity." 440 U.S. at 737-738, quoting *Kimbell Foods, Inc.* v. *Republic Nat'l Bank of Dallas*, 557 F.2d 491, 500 (5th Cir. 1977). The Pennsylvania Supreme Court thus plainly erred in relying on *Kimbell Foods* in determining the scope of the priority created by statute for the collection of non-consensual debts owed by insolvent debtors to the United States "in its tax collecting capacity" (440 U.S. at 738).

The Pennsylvania Supreme Court also erred in concluding that the court should fashion an implied exception from the absolute priority statute for tax claims in order to protect the "legitimate commercial expectations" of other creditors (Pet. App. 13a). The absolute priority statute has been in force for two hundred years, and the proper balance to be achieved between the interests of the United States and other

creditors is a matter for Congress, not the courts, to determine (*Nesbitt* v. *United States*, 445 F. Supp. at 830, adopted by reference, 622 F.2d at 433 (footnotes omitted)):

> The Court is not unmindful of the many policy reasons why the government should not be entitled to priority under [the absolute priority statute] when it is not entitled to priority under the [Federal Tax Lien Act]. However persuasive these policy reasons may be, they do not convince the Court that the [Federal Tax Lien Act] is plainly inconsistent with [the absolute priority statute]. Plaintiff's remedy, if there is to be a remedy, must come from Congress and not the courts.

See also *Estate of Silberman*, 46 Cal. Rptr. 2d at 615.

From its earliest decision under this statute, the Court has consistently held that any assertion that the statute is "inconvenient" to commercial creditors must be addressed to Congress, rather than to the courts. As Chief Justice Marshall explained for the Court in *United States* v. *Fisher*, 6 U.S. (2 Cranch) at 390:

> [I]t would be going a great way to say that a constrained interpretation must be put [on the absolute priority statute], to avoid an inconvenience which ought to have been contemplated in the legislature when the act was passed, and which, in their opinion, was probably overbalanced by the particular advantages it was calculated to produce.
>
> * * * It is for the legislature to appreciate [such inconveniences]. They are not of such magnitude as to induce an opinion that the legislature could not intend to expose the citizens of the United States to them, when words are used which manifest that intent.

Moreover, as the Court emphasized in *United States* v. *Emory*, 314 U.S. at 431, any objection to the application of the statute based upon its "inconvenience" to other creditors simply "proves too much." "If [that objection] is sound as applied to this kind of a claim of the United States, it is equally sound as applied to all claims as to which the United States" has been given an absolute priority under 31 U.S.C. 3713(a). 314 U.S. at 431. "[W]hatever may be the merits of the contention, it should be addressed to Congress and not to this Court." *Ibid.*

CONCLUSION

The judgment of the Supreme Court of Pennsylvania should be reversed.

Respectfully submitted.

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